

**BOARD OF EQUALIZATION****BUSINESS TAXES COMMITTEE MEETING MINUTES**

HONORABLE DEAN F. ANDAL, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: DECEMBER 7, 1999 TIME: 2:00 P.M.

ACTION ITEMS & STATUS REPORT ITEMS**Agenda Item No: 1****Title: Proposed Regulatory Change to Define Food Animals (Regulation 1587)****Issue/Topic:**

Should Regulation 1587 be amended to provide that any animal identified as intended for human consumption by the California Department of Food and Agriculture, in any regulation created pursuant to California Food and Agricultural Code (CFAC) sections 18848 or 25408, would automatically qualify as a food animal for sales and use tax purposes? If approved, this proposed amendment would be made when Regulation 1587 is amended to include the provisions of Senate Bill 963.

Committee Discussion:Action 1 – Consent

There was no discussion of this item.

Action 2 – Amend Regulation 1587 (a)

The Committee was addressed by Ms. Virginia Handley representing The Fund for Animals, Ms. Karen Raasch representing the California Federation for Animal Legislation, Ms. Rose Lernberg representing the Contra Costa Humane Society, and Mr. Richard Matteis representing the California Grain and Feed Association. Ms. Handley, Ms. Raasch and Ms. Lernberg argued that the Board should not rely on regulations of the California Department of Food and Agriculture to identify food animals, since the Board and the Department of Food and Agriculture have different purposes and missions. The Board should independently decide who should receive tax benefits. In addition, the Board should not encourage investment in exotic animals as food sources, which often leads to lost investments and abandoned animals. Ms. Handley referred to a bill pending in the legislature, Assembly Bill 1173, that would add American bison, Asian water buffalo and fallow deer to slaughter provisions of the California Department of Food and Agriculture and authorize the preparation, inspection, and marking of carcasses for transportation and/or sale. Staff noted that it does not appear that the passage of Assembly bill 1173 would have a direct effect on the proposed amendments to Regulation 1587, since the bill does not

reference the Food and Agriculture code sections referenced in the proposed Regulation 1587 amendments.

Mr. Matteis supported staff's recommendation, observing that the proposed amendment would provide consistency and clarity, while removing confusion among retailers as to what are food animals for sales and use tax purposes.

A Committee member observed that staff's proposal would lead to greater efficiency, allowing the state to avoid having to make the decision twice on what constitutes a food animal. The members expressed some concern, however, about the possibility of the Department of Food and Agriculture adopting amendments that would include animals in the definition of food that Regulation 1587 now specifically names as examples of non-food animals (cats, dogs, horses, mink, and canaries). Staff pointed out that Regulation 1587 contains the phrase, "ordinarily constitute food for human consumption," and there was some discussion about the existence of a Food and Agriculture Code section that identifies domesticated animals that cannot be sold for food.

Action 3 – Authorization to Publish

There was no discussion of this item.

Committee Action/Recommendation/Direction:

Action 1 - Consent

The Committee authorized staff to incorporate the provisions of Senate Bill 963 into Regulation 1587.

Action 2 – Amend Regulation 1587 (a)

The Committee supported staff's proposal, and directed staff to include language that ensures the animals currently listed as examples of non-food animals in Regulation 1587 (a) remain categorized as non-food animals for sales and use tax purposes, regardless of amendments to the referenced Food and Agriculture Code sections.

Action 3 – Authorization to Publish

The Committee directed staff to request authority to publish revisions to Regulation 1587 as proposed by staff and modified as described above to address Committee member's concerns. The operative date for the revisions to 1587 (c) and (d)(2) to incorporate the provisions of Senate Bill 963 will be retroactive to January 1, 1997. The operative date for the revisions to 1587 (a) will be January 1, 2000. Implementation will take place upon approval by the Office of Administrative Law.

Following the Committee meeting, the Committee Chair directed staff to include in the proposed amendments to Regulation 1587 (a) a cross reference to any code section that identifies domesticated animals that cannot be sold for food. A copy of the proposed amendments to Regulation 1587 is attached. As requested, references to Penal Code sections 598b and 598c have been included. Penal Code section 598b prohibits the sale for food of any forms of animal life which are commonly kept as pets or companions, and Penal Code section 598c prohibits the sale for human consumption of horses.

Agenda Item No: 2

Title: Proposed Reforms Relating to Drop Shipments (Section 6007)

Issue/Topic:

How can the Board relieve the compliance difficulties facing California (and registered, out-of-state) retailers who drop ship merchandise to consumers in California at the request of out-of-state retailers not registered to collect California sales or use tax?

Committee Discussion:

Action 1 – Consent

The only discussion of this item was in relation to Action 2.

Action 2 – Seek Legislation to Amend Section 6007

Staff provided a brief summary of the history of the amendments to Section 6007.

The following speakers addressed the Committee: Mr. Eric Miethke of Nielson, Merksamer, Parrinello, Mueller, represented Steelcase, Inc.; Mr. Fred Brenner of Steelcase, Inc.; Mr. Doug Boyd, representing Virco and U. S. Laboratories; Mr. Charles Moll of Morrison and Foerster LLP; Mr. Roy Crawford of Brobeck, Phleger and Harrison, representing Mason Shoe; Mr. Greg Turner of California Taxpayer's Association; and Mr. Jim Shay of Marisel, Inc.

The speakers pointed out a number of difficulties facing California retailers or wholesalers who drop ship merchandise to consumers in California at the request of out-of-state retailers. The following problems were summarized by Mr. Moll.

1. Valuation of sale: It is often impossible for the drop shipper to know the amount of the sales price charged by the retailer to the California consumer, even though the drop shipper is held responsible for tax on that sales price.
2. Double collection of tax: Currently, there is no way to prevent the inadvertent collection of tax from both the drop shipper and the consumer.
3. Nexus status of retailer: The drop shipper is not able to determine if the retailer is required to collect use tax from California consumers.
4. Vague statutory language: The language in section 6007 could be construed in a number of ways. Certainty is needed.

Mr. Brenner stated that California sellers are being hurt by the Board's interpretation of section 6007, which creates an incentive for customers to buy from outside the state and imposes a tax on sellers on which it is impossible or infeasible for them to collect reimbursement from the consumer. Mr. Turner cited an example of a company making sales over the internet that has a message on its site stating it will not ship to California due to the state's sales tax laws. Mr. Shay explained that Marisel's out-of-state customers sometimes request that merchandise be mailed to

them for re-delivery to their California customer, due to section 6007 requirements. This is an inefficient way to do business. Mr. Brenner stated that Steelcase supports the staff proposal, would not like to see any of the other proposals from industry abandoned, but is not prepared at this time to support any of these proposals. Mr. Miethke stated that although the staff proposal assists those with out-of-state locations, it still leaves California sellers with the problems of an undeterminable retail selling price and the potential for double collection of tax. Mr. Crawford suggested that the staff's interpretation of 6007 may be incorrect, and that the problem with staff's proposal is that the solution would not be retroactive.

Possible solutions to the difficulties cited were discussed, including:

1. Valuation of sale: It was suggested that a rebuttable presumption could be adopted that the selling price on which tax is due is equal to the drop shipper's selling price plus some percentage, or that the drop shipper could be held responsible for tax only on the price charged by the drop shipper to its own customer (the retailer).
2. Nexus status of retailer: It was suggested that the drop shipper could have a contractual agreement with the retailer for reimbursement of tax owed by the drop shipper. It was argued, however, that this would chase customers away from California sellers.

The Committee Chair noted that all were in agreement that the compliance burdens imposed by section 6007 are unacceptable. However, all the solutions proposed by industry would result in moving the tax obligation from the wholesaler to consumer, and could dramatically expand the Board's audit responsibilities. The Chair also observed that the subject of drop shipments is very complex, composed of a number of issues, and recommended working on those issues systematically.

Committee Action/Recommendation/Direction:

Action 1 – Consent

The Committee directed staff to work with industry to develop administrative procedures that will minimize the possibility that use tax is inadvertently collected from both the drop shipper and the California end user.

Action 2 – Seek Legislation to Amend Section 6007

The Committee approved staff's proposal to seek legislation to amend section 6007 to apply drop shipment rules only to drop shipments from California.

It was decided that the discussion of the valuation of sales would be referred to Mr. Chiang for consideration as a future Business Taxes Committee issue.

Action 3 – Approve Submission of Proposal to the Legislative Committee

The Committee directed staff to submit to the Legislative Committee its proposal to amend section 6007 to apply drop shipment rules only to drop shipments from California.

Agenda Item No: 3**Title: Proposed Office Location for Southern California Investigations Division****Issue/Topic:**

Report the findings of the confidential survey conducted of the Southern California Investigations personnel.

Committee Discussion:

Ms. Sally Lee, Deputy Director Administration, provided the results of the confidential survey. Ms. Rosemarie Duffy was present representing the California State Employees Association (CSEA). 25 employees were surveyed and the following statistics were compiled.

- Of the 17 employees assigned to the Riverside office, nine (9) indicated that they preferred to remain at their current office location.
- Of the eight (8) employees assigned to the Torrance office, two (2) indicated that they preferred to remain at their current office location.
- Of the 17 Riverside employees, seven (7) indicated a willingness to be reassigned to Norwalk.
- Of the eight (8) Torrance employees, seven (7) indicated a willingness to be reassigned to Norwalk. These seven (7) included one employee who also indicated that he/she preferred to remain in his/her current office location.

One employee has been out of the office and unable to complete the survey.

A discussion followed concerning the procedures used to conduct the survey and why there was no input from the Board Members or CSEA. It was pointed out that the survey was to be confidential and the details shared with no one per instructions from the previous Committee meeting on November 19, 1999.

Committee Action/Recommendation/Direction:

Staff is to conduct meet and confer meeting(s) with the Department of Personnel and CSEA, in accordance with established contract provisions, and report back to the Board with the results.

Approved: /s/ Dean F. Andal
Honorable Dean F. Andal, Committee Chair

/s/ E. L. Sorensen, Jr.
E. L. Sorensen, Jr., Executive Director

BOARD APPROVED

at the 12-9-99 Board Meeting

/s/ Janice Masterton
Janice Masterton, Chief
Board Proceedings Division

Regulation 1587. ANIMAL LIFE, FEED, DRUGS AND MEDICINES.

(a) ANIMAL LIFE. Tax does not apply to sales of any form of animal life of a kind the products of which ordinarily constitute food for human consumption (food animals), as for example, cattle, sheep, swine, baby chicks, hatching eggs, fish, and bees. Operative January 1, 1993, food animals include ostriches. Operative January 1, 1996, food animals include emus.—Operative January 1, 2000, the term “food animals” includes any form of animal life classified by the California Department of Food and Agriculture, by regulation, as livestock or poultry intended for human consumption under Sections 18848 and 25408 of the California Food and Agricultural Code. Tax shall not apply to sales of such newly defined food animals on or after the date the related California Food and Agricultural regulation is effective.

The term “food animals” does not include any forms of animal life which are commonly kept as pets or companions, the sale of which for food is prohibited by Penal Code Section 598b, nor does it include any horse, the sale of which for human consumption is prohibited by Penal Code Section 598c. Tax does apply, however, to retail sales (including sales for breeding purposes) of any form of animal life not of such a kind (non-food animals), as for example, cats, dogs, horses, mink, and canaries. For example, cats, dogs, horses, mink, and canaries are not food animals.

(b) FEED.

(1) DEFINITION. The term "feed" as used herein includes cod-liver oil, salt, bone meal, calcium carbonate, double purpose limestone granulars and oyster shells, but does not include sand, charcoal, granite grit, sulphur and medicines. It also includes any item which is purchased for use as an ingredient of a product which would constitute a feed were the product itself sold.

(2) APPLICATION OF TAX.

(A) In General. Tax does not apply to sales of feed for food animals or for any non-food animals which are to be sold in the regular course of business.

(B) Cellulose Casings. Tax does not apply to the sale or use of cellulose casings used in the manufacture and production of processed meat products which are ultimately resold as, or incorporated into, feed for food animals or non-food animals which are to be sold in the regular course of business.

(C) Medicated Feed. Tax does not apply to the sale of medicated feed, the primary purpose of which is prevention and control of disease of food animals or of non-food animals which are to be sold in the regular course of business. Tax also does not apply to sales of the particular ingredients purchased from different sellers by a purchaser who mixes them for feeding to such animal life, in such proportions that the product is an exempt medicated feed rather than a drug.

(c) DRUGS OR MEDICINES.

(1) DEFINITIONS. The term “drugs or medicines, the primary purpose of which is the prevention and control of disease,” as used herein, means and includes any livestock drug approved by the United States Food & Drug Administration, which are defined and registered pursuant to California Food & Agricultural Code Sections 14202, 14206, and 14281. The term also includes vitamins as well as insecticides which are labeled for livestock use and which are administered directly to the livestock. The term includes, but is not limited to, legend drugs, pills and capsules, liquid medications, injected drugs, ointments, vaccines, intravenous fluids, and medicated soaps. “Livestock” includes poultry. “Livestock drug” means any drug, combination of drugs, proprietary medicine, or combination of drugs and other ingredients which is prepared for administration to livestock. On or after January 1, 1997, the term “drugs and medicines” also includes oxygen administered to food animals, as provided in (c)(2)(A) below.

(2) APPLICATION OF TAX.

(A) OXYGEN. On or after January 1, 1997, tax does not apply to the sale or use of oxygen administered to food animals for the primary purpose of preventing or controlling disease, including oxygen injected into ponds or tanks that house or contain aquatic species raised, kept, or used as food for human consumption. However, tax does apply to the sale or use of oxygen administered to nonfood animals whether or not the animals are being held for sale in the regular course of business.

(2B) ADMINISTERED DIRECTLY. Prior to January 1, 1997, except as provided in Regulation 1506 (18 CCR 1506), subdivision (h), dealing with licensed veterinarians, tax applies to the sale or use of drugs or medicines as defined in subdivision (c)(1) which are administered directly to animal life. Operative January 1, 1997, tax does not apply to the sale or use of drugs or medicines as defined in subdivision (c)(1) which are administered directly (e.g., orally, hypodermically, or topically or externally as injections, implants, drenches, repellents, or pour-ons) to food animals. The sale or use of drugs or medicines as defined in subdivision (c)(1) administered directly to non-food animals are subject to tax regardless that such animals are being held for sale in the regular course of business.

(3C) MIXED WITH FEED OR DRINKING WATER. Prior to April 1, 1996, tax applies to the sale or use of drugs or medicines as defined in subdivision (c)(1) administered to animal life as an additive to feed (except as provided in (b)(2)(B) above) or to drinking water. Operative April 1, 1996, tax does not apply to the sale or use of such drugs or medicines administered as an additive to, or component of, feed or drinking water for food animals or for nonfood animals being held for sale in the regular course of business.

(d) EXEMPTION CERTIFICATES.

(1) FEED. Sellers of feed should secure feed exemption certificates with respect to sales of feed of a kind customarily used both to feed food animals and to feed non-food animals which is purchased for food animals, and with respect to sales of all feed which is purchased for non-food animals being held for sale in the regular course of business. The following form of certificate is suggested:

"I hereby certify that all of the feed which I shall purchase from_____

will be purchased for use as feed for food animals or for non-food animals which are being held for sale in the regular course of business. This certificate shall be considered a part of each order which I give unless such order shall otherwise specify. This certificate shall be good until revoked in writing.

Signature_____

Address_____

Occupation_____

Seller's Permit No. (if any)_____

Sellers of feed need not secure feed exemption certificates with respect to sales of feed of a kind ordinarily used only in the production of meat, dairy or poultry products for human consumption or with respect to sales in small units (two standard sacks of grain or less and/or four bales of hay or less) of feed of a kind customarily used either for food production or other purposes (feeding work stock), or with respect to sales of feed that is specifically labeled by the manufacturer for food animals. In the absence of evidence to the contrary, it will be presumed that all such feed are to be used in producing meat, dairy or poultry products for human consumption.

(2) DRUGS OR MEDICINES.

(A) Administered Directly. Operative January 1, 1997, persons who buy drugs or medicines as defined in subdivision (c)(1), which will be administered directly (e.g., orally, hypodermically, or topically or externally as injections, implants, drenches, repellents, or pour-ons) to food animals, should give the vendor an exemption certificate similar to the example in subdivision (d)(2)(C) below.

(B) To be Mixed With Feed or Drinking Water. Operative April 1, 1996, persons who buy drugs or medicines as defined in subdivision (c)(1) to be mixed with feed or drinking water, for food animals or of non-food animals being held for sale in the regular course of business, should give the vendor an exemption certificate similar to the example in subdivision (d)(2)(C) below.

(C) Sellers of drugs or medicines to be mixed with feed or drinking water for food animals or for non-food animals being held for sale in the regular course of business, ~~or~~ to be administered directly to a food animal, or, if oxygen, administered to a food animal such as by pumping or injecting the oxygen into the animal's living environment should request a certificate similar to the following from the buyer:

"I hereby certify that the drugs or medicines which I shall purchase from _____
_____ will be purchased

☐ as an additive to feed or drinking water for food animals or for non-food animals being held for sale in the regular course of business, ~~or~~

☐ for administration directly to a food animal, or

☐ for oxygen administered to a food animal.

This certificate shall be considered a part of each order which I give unless such order shall otherwise specify. This certificate shall be good until revoked in writing.

Signature _____
Address _____
Occupation _____
Seller's Permit No. (if any) _____

(3) INVOICES RELATED TO EXEMPTION CERTIFICATES. Exemption certificates should be complete with the information specified in the above forms, including the names and addresses of the purchasers, in order to constitute adequate support for exemptions claimed by sellers. In addition, the invoices on sales claimed as exempt should specify the names of the purchasers in order to relate them to exemption certificates.

Note: Authority: Section 7051, Revenue and Taxation Code.
Reference: Government Code Section 11343. and Sections 6018.1, 6358, and 6358.4, Revenue and Taxation Code.